



Signed and Filed: January 16, 2015

A handwritten signature in dark ink, appearing to read "T. E. Carlson".

THOMAS E. CARLSON  
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re	)	Case No. 13-11774 AJ
	)	
DEBORAH MYNETTE MCINTOSH,	)	Chapter 13
	)	
	)	
	)	
	)	
	)	
Debtor.	)	
	)	

**MEMORANDUM DECISION RE FEE APPLICATION OF DEBTOR'S FORMER COUNSEL**

On October 21, 2014, the court held a hearing on the following three matters: Debtor's motion to dismiss the chapter 13 case; the fee application of Debtor's former counsel; and the motion of Debtor's former counsel to have the proceeds of the sale of Debtor's residence distributed to the Chapter 13 Trustee. Paul M. Jamond appeared for Debtor. David N. Chandler, Jr. and David N. Chandler, Sr. appeared as Debtor's former counsel. Lilian G. Tsang appeared for David Burchard, Chapter 13 Trustee. Brian H. Tran appeared for secured creditor, CalHFA Mortgage Assistance Program ("CalHFA").

At the hearing the court stated it would grant Debtor's motion

1 to dismiss. For the reasons set forth below, the court now denies  
2 the former counsel's motion regarding distribution of sale  
3 proceeds, and denies Debtor's former counsel all fees.<sup>1</sup>

4 **BACKGROUND**

5 Debtor filed bankruptcy to deal with attorneys' fees she  
6 incurred in contesting a will. She owed more than \$400,000 to  
7 Carr, McClellan, Ingersoll, Thompson & Horn ("CMITH"), and had  
8 given CMITH a deed of trust on her residence to secure repayment of  
9 that debt.

10 Debtor hired David N. Chandler, p.c. to file a Chapter 13 case  
11 for her. That law office is a father-son combination of David N.  
12 Chandler, Sr. and David N. Chandler, Jr. Both have extensive  
13 bankruptcy experience. It appears that virtually all of the work  
14 on this case was performed by David N. Chandler, Jr. ("Chandler").

15 The central issue in the present matter is whether Chandler  
16 violated his duty of loyalty to his client. While he represented  
17 Debtor, Chandler argued that the CMITH deed of trust should be  
18 invalidated under state law, that this deed of trust should not be  
19 preserved for the benefit of the bankruptcy estate, and that the  
20 equity created by the invalidation of the CMITH deed of trust  
21 should instead be used to pay Debtor's homestead exemption. After  
22 he was discharged by Debtor, Chandler argued that the CMITH deed of  
23 trust was avoided under section 544 of the Bankruptcy Code, that  
24 the deed of trust was automatically preserved for the benefit of  
25 the bankruptcy estate, that Debtor was not entitled to receive any  
26 portion of the proceeds of the sale of the residence in respect of  
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28 <sup>1</sup> All matters prior to confirmation were heard by Judge  
Jaroslovsky. This post-confirmation proceeding was assigned to the  
above-signed Judge by Judge Jaroslovsky.

1 her homestead exemption, and that the sale proceeds must instead be  
2 used to pay the claims of unsecured creditors (which would mean  
3 that the proceeds would be used to pay Chandler's fees).

4 Chandler filed a chapter 13 petition for Debtor on September  
5 18, 2013. He devised the following four-part strategy for dealing  
6 with the CMITH deed of trust through that bankruptcy case.

7 First, Debtor claimed a homestead exemption in her residence.  
8 That claim of exemption was allowed when no timely objection was  
9 filed.

10 Second, Debtor filed an adversary proceeding in which she  
11 alleged that the CMITH deed of trust was invalid under Rule 3-300  
12 of the California Rules of Professional Conduct, because CMITH had  
13 not warned Debtor to seek advice from separate counsel before  
14 engaging in the transaction with her attorneys. Docket No. 31.  
15 The complaint sought such relief solely on the basis of Rule 3-300  
16 and did not seek relief under any provision of the Bankruptcy Code.

17 Third, Debtor filed a motion to sell her residence free and  
18 clear of the CMITH deed of trust on the basis that the validity of  
19 that lien was in bona fide dispute. Docket No. 58. In describing  
20 the dispute concerning the validity of the lien, the motion cited  
21 only Rule 3-300.

22 Fourth, Debtor filed a chapter 13 plan that also sought to  
23 disallow the secured claim of CMITH and preserve the resulting  
24 benefit for Debtor. Docket No. 21. Section 6.01 of the plan  
25 provides that if Debtor prevails in invalidating the CMITH deed of  
26 trust, "the Debtor shall be entitled to funds representing her  
27 allowed homestead exemption" after payment of the remaining deeds  
28 of trust.

1 To explain the significance of what Chandler did next, it is  
2 necessary to summarize certain provisions of the Bankruptcy Code.  
3 First, various sections of the Code enable a bankruptcy trustee to  
4 set aside transfers made by the debtor that the debtor could not  
5 set aside under non-bankruptcy law. 11 U.S.C §§ 544, 547, 548,  
6 549. Second, when a transfer is avoided under one of these  
7 sections of the Bankruptcy Code, it is automatically "preserved for  
8 the benefit of the estate" under section 551. In the present case,  
9 the CMITH deed of trust was a transfer by the Debtor. If that  
10 transfer was preserved for the benefit of the estate, the deed of  
11 trust would not go away and the estate would step into the shoes of  
12 CMITH as the holder of the secured claim against the Residence. If  
13 the CMITH deed of trust was instead declared unenforceable under  
14 Rule 3-300, then the CMITH lien against the Residence would simply  
15 disappear. Third, a debtor can claim an exemption in property that  
16 was transferred pre-petition and recovered by the estate if the  
17 pre-petition transfer was an *involuntary* transfer. 11 U.S.C. §  
18 522(g)(1)(A).

19 As noted above, it was Debtor's objective to obtain the net  
20 proceeds from the sale of her residence in respect of her homestead  
21 exemption. In the legal context just described, this objective was  
22 furthered by (a) using Rule 3-300 to invalidate the CMITH deed of  
23 trust, and (b) urging that the CMITH deed of trust was not a  
24 voluntary transfer. Invalidating the lien under Rule 3-300 would  
25 create equity to which the homestead exemption could attach by  
26 causing the CMITH lien to disappear. Showing that the CMITH deed  
27 of trust was not a truly voluntary transfer would eliminate a  
28 possible objection to the homestead exemption.

1 On December 11, 2013, the court held a preliminary hearing  
2 regarding confirmation of the chapter 13 plan. Judge Jaroslovsky  
3 asked whether the CMITH lien would be preserved for the benefit of  
4 creditors if it were invalidated. In response, Chandler argued  
5 that the CMITH lien would not be preserved for creditors because it  
6 was not being avoided under the Bankruptcy Code.

7 We're not avoiding [the CMITH deed of trust] under a rule  
8 that would require preservation for the benefit of the  
9 estate. It's a void [sic] for clear violation of rule  
3300...."

10 Chandler also argued that the transfer was not truly voluntary  
11 (which means the Debtor could exempt the value created by setting  
12 aside the CMITH deed of trust).

13 Well, the idea is this: by virtue - 3300 has to do with  
14 informed consent. When you make a voluntary transfer and  
15 you then avoid it, it would typically be for the benefit  
16 of the estate. But when you have a failure under 3300  
17 then you don't have a consensual transfer because it  
wasn't voluntary by definition, you are not voiding it  
under the Bankruptcy Code, you are voiding it under the  
Rules of Professional Conduct.

18 On January 21, 2014, Judge Jaroslovsky approved the sale of  
19 Debtor's residence free and clear of liens. Docket No. 71. The  
20 approved sale price was \$750,000. Taxes and two deeds of trust  
21 senior to the CMITH deed of trust would be paid upon closing. The  
22 remaining sale proceeds would be held in escrow pending resolution  
23 of the dispute regarding the CMITH deed of trust. Docket No. 91.

24 In early February 2014, Debtor reached a settlement with  
25 CMITH. Under that settlement, CMITH agreed to reconvey its deed of  
26 trust, to release its *in personam* claim against Debtor, and to pay  
27 Debtor \$10,000. Docket No. 86. Judge Jaroslovsky approved  
28 this settlement in an order entered on February 10, 2014. Docket

1 No. 91. Chandler retained the \$10,000 in payment of fees owed him  
2 by Debtor.

3 On February 12, 2014, Chandler filed a First Amended Chapter  
4 13 Plan that implemented the CMITH settlement. Docket No. 93. The  
5 amended plan provided clearly that the sale proceeds freed up  
6 through the invalidation of the CMITH deed of trust would be used  
7 to pay Debtor's homestead exemption.

8 Closing costs and the secured claims of Bayview Loan  
9 Servicing, PNC Bank, CalHFA Mortgage Assistance Corp.  
10 and any amount due the Napa County Tax Collector shall  
11 be paid by the Debtor directly from escrow with proceeds  
12 from the sale. *The Debtor shall receive net proceeds  
13 from the sale on account of her homestead exemption.*

14 Section 6.01 of Amended Plan (emphasis added).

15 The amended plan was unopposed when it came before the court  
16 for confirmation on February 12, 2014. The written order  
17 confirming the plan was entered on April 3, 2014. Docket No. 103.  
18 No appeal was filed.

19 The sale of the residence closed in March 2014. As of the  
20 October 22, 2014 hearing, \$57,712 remained in escrow subject to the  
21 \$21,000 secured claim of CalHFA and Debtor's homestead exemption.

22 A disagreement arose between Debtor and Chandler during the  
23 summer of 2014, presumably over the payment of fees. Chandler had  
24 received a pre-petition retainer of \$3,500. He had also received  
25 the \$10,000 settlement paid by CMITH. The confirmed plan approved  
26 additional fees in the amount of \$3,000 to be paid at the rate of  
27 \$273 per month for 60 months. Chandler has received \$2,093 through  
28 these plan payments. From all these sources combined, Chandler has  
received the sum of \$15,593.

On August 19, 2014, Debtor discharged Chandler and substituted

1 Paul M. Jamond as her counsel. Docket Nos. 109-10.

2 On August 27, 2014, Chandler filed the fee application at  
3 issue here, seeking fees and costs in the amount of \$75,671 (after  
4 application of the retainer and payments previously received).  
5 Docket No. 113.

6 On September 5, 2014, Chandler filed the Motion for Order  
7 Directing Escrow Company to Pay Net Sales Proceeds to Chapter 13  
8 Trustee (the "Distribution Motion"). In the Distribution Motion,  
9 Chandler states:

10 The [CMITH] deed of trust was avoided under the authority  
11 of section 544 of the [Bankruptcy] Code. 11 U.S.C. 544.  
12 The avoided [CMITH] Deed of Trust was automatically  
13 preserved for the benefit of the Bankruptcy Estate. 11  
14 U.S.C. 551.

15 Docket No. 120 at page 2, par.8.

16 In his declaration in support of the Distribution Motion,  
17 Chandler makes the following additional statements:

18 I argued that, upon avoidance of the [CMITH] Deed of  
19 Trust, the subordinate CalHFA Deed of Trust would improve  
20 position and the Debtor would have an exemption in the  
21 remaining equity.

22 Docket No. 125 at 4.

23 Following confirmation and after conducting legal  
24 research in the months of June and July 2014, I reached  
25 the conclusion that the Court was correct and that  
26 preservation of the avoided [CMITH] lien for the estate  
27 occurred automatically. However, in so concluding, I was  
28 mindful that my office's interest in the case had become  
adverse to that of the Debtor on the issue of disposition  
of sale proceeds.

Id. at 8.

I tried to explain [to Debtor's new counsel] the  
complexity of the situation and the legal issues  
involved, including § 522(g) and § 551.

Id. at 11.

1 The reference to section 522(g) suggests that Chandler was now  
2 arguing that the CMITH deed of trust was a voluntary transfer.

3 At the October 21, 2014 hearing, Chandler argued that none of  
4 the remaining proceeds should be distributed to the Debtor in  
5 respect of her homestead exemption. Chandler argued that the CMITH  
6 deed of trust was preserved for the estate under section 551,  
7 because it had been avoided under section 544 of the Bankruptcy  
8 Code. He said this despite the fact that the adversary complaint  
9 he drafted sought to avoid the CMITH lien solely on the basis of  
10 Rule 3-300 and never mentioned section 544. Docket No. 31, ¶¶ 13-  
11 16, 25-31. Chandler argued that the preservation of the CMITH lien  
12 left no equity to which the homestead exemption could attach. He  
13 said this despite the fact that the confirmed chapter 13 plan he  
14 drafted specified that sale proceeds were to be used to pay  
15 Debtor's homestead exemption.

16 **DISCUSSION**

17 **A. Motion to Distribute Sale Proceeds to Chapter 13 Trustee**

18 Chandler argues that the net proceeds from the sale of  
19 Debtor's residence should be distributed to the Chapter 13 trustee,  
20 because the CMITH deed of trust was preserved for the benefit of  
21 the estate and all of the net proceeds are fully encumbered by that  
22 preserved lien. This argument fails for two reasons.

23 First, the CMITH deed of trust was not preserved for the  
24 benefit of the estate under section 551, because that section  
25 applies only to transfers avoided under sections 522, 544, 545,  
26 547, 548, 549, 724(a), or 506(d) of the Bankruptcy Code. As noted  
27 previously, the adversary proceeding under which the CMITH deed of  
28 trust was invalidated was brought solely under Rule 3-300 of the



1 California Rules of Professional Conduct, and did not seek to avoid  
2 the lien under any of the provisions of the Bankruptcy Code listed  
3 in section 551. Docket No. 31, ¶¶ 13-16, 25-31.

4 Second, the confirmed chapter 13 plan provides that the CMITH  
5 deed of trust is not preserved for the benefit of the estate. As  
6 noted previously, section 6.01 of the plan provides that if Debtor  
7 prevails in her dispute with CMITH, the CMITH lien is to become  
8 void and the resulting increase in equity is to be used to pay the  
9 fourth deed of trust and Debtor's homestead exemption. The  
10 treatment of a secured claim and the disposition of the collateral  
11 securing that claim are proper subjects of a chapter 13 plan.  
12 § 1322(b). The order confirming Debtor's plan was not appealed, is  
13 now a final order, and is *res judicata* regarding the treatment of  
14 secured claims and collateral provided for in the plan.<sup>2</sup> Moreover,  
15 under section 1330, the order confirming plan cannot be revoked,  
16 because it was entered on April 3, 2014, because neither Chandler  
17 nor any other party have sought revocation of that order to date,  
18 and because more than 180 days have passed since entry of the  
19 order.

20  
21 <sup>2</sup> Chandler argued at the October 21, 2014 hearing that the  
22 order confirming plan specified that the validity of the CMITH lien  
23 had not been resolved. Chandler apparently relied upon paragraph 2  
24 of that order, which states: "No lien on real property shall be  
25 removed, avoided or extinguished except by adversary proceeding  
26 pursuant to Rule 7001(2) of the Federal Rules of Bankruptcy  
27 Procedure or contested matter pursuant to Rule 3012 of the Federal  
28 Rules of Bankruptcy Procedure." Chandler's argument is  
unpersuasive for at least two reasons. First, Debtor filed an  
adversary proceeding to avoid the CMITH lien, and it was through  
the settlement of that adversary proceeding that the lien was  
avoided. Second, under the settlement, CMITH reconveyed the deed  
of trust, so that the lien was not avoided through confirmation of  
the plan. The plan specified the effect of the invalidation of the  
lien, and that effect was not called into question by the language  
of the confirmation order.

1       The escrow agent will be ordered to distribute the sale  
2 proceeds it is still holding (approximately \$57,713) as agreed upon  
3 by the Debtor and the holder of the remaining deed of trust:  
4 \$21,000 to CalHFA Mortgage Assistance Corporation in respect of its  
5 fourth deed of trust; the remainder to Debtor in respect of her  
6 homestead exemption.

7       **B. Chandler Fee Application**

8       The principal question regarding Chandler's fees application  
9 is whether he should be denied fees because he violated his duty of  
10 loyalty to his former client. More specifically, the question is  
11 whether Chandler is now permitted to argue that the CMITH deed of  
12 trust was preserved for the benefit of the estate (a position that  
13 hurts his former client and helps him) after he previously argued  
14 on behalf of this client that the CMITH deed of trust was **not**  
15 preserved for the benefit of the estate. The issue is of great  
16 importance to Debtor. If the CMITH lien is not preserved for the  
17 estate, as Chandler argued when he represented Debtor, Debtor will  
18 receive approximately \$36,713 in respect of her homestead  
19 exemption.

20       Chandler contends he is now free to argue that the CMITH lien  
21 was preserved for the estate, because he advised his client of the  
22 conflict of interest and advised her to seek separate counsel. He  
23 offers no evidence that he obtained a written waiver of conflict of  
24 interest that would enable him to represent an interest adverse to  
25 Debtor on this matter. Chandler lays great stress on his assertion  
26 that the court has not yet decided whether the lien was preserved  
27  
28

1 for the benefit of the estate,<sup>3</sup> and that his current position is  
2 legally correct.

3 I determine that Chandler has blatantly violated his duty of  
4 loyalty to Debtor, and that he should be denied all fees as a  
5 result of his misconduct.

6 At the outset, it is important to note that Chandler's breach  
7 of loyalty is not in his attempt to collect fees from Debtor. An  
8 attorney must always be free to pursue his client for fees if he or  
9 she does so properly. Chandler's breach of duty arises from the  
10 fact that he is taking a position adverse to his former client on  
11 an issue on which he previously represented the client and that is  
12 separate from the fees he is seeking to collect. With respect to  
13 that separate issue, it does not matter whether the court has  
14 decided the issue, or whether the position Chandler is currently  
15 taking is legally correct. An attorney who advocates a position on  
16 behalf of a client cannot switch sides simply because the issue has  
17 not yet been decided and/or he now believes the position he  
18 previously asserted on behalf of the client is wrong.

19 An attorney's duty of loyalty is defined by state law. Under  
20 California law, that duty is defined by the following principles.  
21 First, the duty of loyalty continues after the client has  
22 discharged the attorney. Oasis West Realty, LLC v. Goldman, 51  
23 Cal. 4th 811, 821 (Cal. 2011). Second, an attorney "may not do  
24 anything which will injuriously affect [the] former client in any  
25 matter in which [the attorney] formerly represented [the client]."  
26 Id. This is so even if the action injurious to the former client  
27 does not involve the use or disclosure of confidential information.

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<sup>3</sup> The court has determined that the lien was *not* preserved.  
See note 2, supra.

1 People ex rel. Deukmajian v. Brown, 29 Cal. 3d 150, 156 (Cal.  
2 1981). Third, the duty of loyalty is not limited to situations in  
3 which the attorney represents a new client. An attorney breaches  
4 the duty of loyalty in taking action on his or her own behalf, if  
5 that action is injurious to a former client on a matter in which  
6 the attorney represented that client. Oasis, 51 Cal. 4th at 822-  
7 24.

8 As noted above, Chandler argued to this court in December 2013  
9 that the CMITH lien was not preserved for the estate and that the  
10 equity created by removing that lien would be used to pay Debtor's  
11 homestead. The court entered an order to that effect when it  
12 confirmed Debtor's First Amended Chapter 13 Plan. Chandler took  
13 action that injuriously affected his former client in a matter in  
14 which he formerly represented that client when he argued in October  
15 2014 that the CMITH lien was preserved, and that Chandler and the  
16 estate, rather than Debtor, should benefit from the invalidation of  
17 the CMITH lien. This was a clear violation of the duty of loyalty  
18 as defined by the California Supreme Court.

19 This court has discretion under both state law and bankruptcy  
20 law to deny some or all fees to an attorney who has breached  
21 ethical requirements. In re Wiredyne, 3 F.3d 1125, 1128 (7th Cir.  
22 1993); In re McGregory, 340 B.R. 915, 922-23 (8th Cir. BAP 2006);  
23 In re Vann, 136 B.R. 863, 869-71 (D. Colo. 1992), aff'd 986 F.2d  
24 1431 (10th Cir. 1993); In re Wilde Horse Enterprises, Inc., 136  
25 B.R. 830, 844 (Bankr. C.D. Cal. 1991); Clark v. Millsap, 197 Cal.  
26 765, 785 (Cal. 1926); Cal Pak Delivery, Inc. v. United Parcel  
27 Service, Inc., 52 Cal. App. 4th 1, 14-16 (Cal. Ct. App. 1997). Cf.  
28 Matter of Rancho Motor Inn, Inc., 527 F.2d 1044, 1047-48 (9th

1 Cir. 1995) (denial of fees to management company because of  
2 misconduct).

3 In exercising this discretion, I determine that Chandler's  
4 breach of ethical duty was so flagrant that he should be denied the  
5 fees he now seeks, and be required to refund all fees he has  
6 previously received. First, the breach of loyalty was stark.  
7 Chandler specifically argued that the CMITH lien was not preserved,  
8 obtained that result through the confirmed plan, then specifically  
9 argued that the lien was preserved. Second, Chandler made a  
10 blatant misrepresentation to this court. In arguing that the CMITH  
11 lien was preserved, he stated that it had been avoided under  
12 section 544 of the Bankruptcy Code (which would result in  
13 preservation of the lien). Docket No. 120, ¶¶ 7, 8. In fact, the  
14 adversary proceeding against CMITH, which Chandler drafted and  
15 filed, sought to invalidate the lien solely on the basis of Rule 3-  
16 300 of the California Rules of Professional Conduct (which resulted  
17 in the elimination of the lien). Docket No. 31, ¶¶ 13-16, 25-31.  
18 Third, Chandler's reversal of course was for the purpose of  
19 collecting his fees, and sought to deprive his former client of her  
20 homestead exemption - one of the most important protections  
21 provided debtors under both state and Federal law. Fourth,  
22 Chandler understood all of this. Although the question whether the  
23 CMITH lien was preserved may appear technical and confusing to an  
24 attorney who does not regularly practice bankruptcy law, Chandler  
25 specializes in bankruptcy law and understood the meaning of  
26 everything he did. Any doubt about that is dispelled when one sees  
27 the technical virtuosity with which he first argued that the lien  
28 was not preserved and then argued that it was preserved.

1 I determine that this remedy fully compensates Debtor for all  
2 harm caused by Chandler's breach of duty. Requiring Chandler to  
3 refund the \$15,593 he already received should be sufficient to  
4 cover the fees that Debtor incurred in responding to Chandler's fee  
5 application, Chandler's motion to distribute proceeds, and  
6 Chandler's opposition to Debtor's motion to dismiss her chapter 13  
7 case.

8 **\*\*END OF MEMORANDUM DECISION\*\***